

TENNESSEE DEPARTMENT OF REVENUE
LETTER RULING # 96-36

WARNING

Letter rulings are binding on the Department only with respect to the individual taxpayer being addressed in the ruling. This presentation of the ruling in a redacted form is informational only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Department policy.

SUBJECT

Whether, under the facts presented, Company X will be considered a financial institution for Tennessee franchise, excise tax purposes, whether it will be required to file a combined franchise, excise tax return with its parent and how it will compute its franchise, excise tax apportionment formula.

SCOPE

This letter ruling is an interpretation and application of the tax law as it relates to a specific set of existing facts furnished to the Department by the taxpayer. The rulings herein are binding upon the Department, and are applicable only to the individual taxpayer being addressed.

This letter ruling may be revoked or modified by the Commissioner at any time. Such revocation or modification shall be effective retroactively unless the following conditions are met, in which case the revocation shall be prospective only:

- (A) The taxpayer must not have misstated or omitted material facts involved in the transaction;
- (B) Facts that develop later must not be materially different from the facts upon which the ruling was based;
- (C) The applicable law must not have been changed or amended;
- (D) The ruling must have been issued originally with respect to a prospective or proposed transaction; and
- (E) The taxpayer directly involved must have acted in good faith in relying upon the ruling and a retroactive revocation of the ruling must inure to his detriment.

FACTS

The Taxpayer is a [STATE A - NOT TENNESSEE] corporation with multistate activities. Its headquarters are located in [STATE B - NOT TENNESSEE]. The stock of

The Taxpayer is publicly held and actively traded over the New York and regional stock exchanges. The tax year of The Taxpayer is a calendar year and it files a consolidated federal income tax return with its subsidiaries.

The Taxpayer is a manufacturer whose primary business operations include:

(1) The production and marketing of products ([CONTENT OF PRODUCTS]) for [PURPOSE AND USE OF PRODUCTS], and other uses in the home and in business and industry.

(2) The production and marketing of [PRODUCT] requiring specialized technology in development or application, as well as traditional [PRODUCT] and related products for [TYPE BUSINESS] and other [BUSINESS] needs.

The Taxpayer sells its products to commercial wholesalers and retailers and generates more than 50% of its income from its manufacturing operations. It is an accrual method taxpayer that records sales under various payment and credit terms that create accounts receivable. The Taxpayer typically does not require collateral to secure its accounts receivable and does not retain a security interest in the products it sells.

The Taxpayer is considering forming Company X which will be a wholly owned Tennessee corporation with multistate operations which give it tax nexus in other states. Its sole office will be in Tennessee. Thus, Company X will maintain its principal place of business in Tennessee. Company X's employees, which are currently employed by The Taxpayer and will be transferred to Company X upon Company X's formation, will perform servicing, administration and collection of the receivables.

Initially, Company X will probably make no loans. Company X will purchase, without recourse, The Taxpayer's accounts receivable generated from the sale of goods. The purchases will take place every ten (10) days or on a similar periodic basis. Company X will purchase these receivables at their market value, and bear the risks and rewards of ownership of the receivables and be responsible for collection and maintenance of the receivables.

Company X may also be engaged to provide credit approval services to The Taxpayer and to service accounts receivable generated and held by The Taxpayer prior to their sale to Company X.

The income Company X receives from its factoring business will be classified as ordinary income on its federal income tax return and will generate more than fifty percent of its gross income.

QUESTIONS PRESENTED

1. For Tennessee corporate franchise, excise tax purposes, is Company X a financial institution?

2. Will Company X be required to file a combined Tennessee corporate franchise, excise tax return with [THE TAXPAYER]?
3. How will the interest income and other receipts that Company X earns from the collection of receivables be apportioned for Tennessee corporate franchise, excise tax purposes?

RULINGS

1. Yes.
2. No.
3. Company X will use a single factor gross receipts apportionment formula. All interest income and other receipts from the accounts receivable purchased from The Taxpayer will be included in the denominator of Company X's apportionment formula. Interest income and other receipts from such accounts receivable will be included in the numerator of Company X's apportionment formula to the extent that sale property related to the accounts receivable was delivered or shipped by The Taxpayer to a purchaser or recipient located in Tennessee.

ANALYSIS

1. *COMPANY X IS A FINANCIAL INSTITUTION*

For purposes of the Tennessee corporate franchise, excise tax, T.C.A. §67-4-804(a)(7) defines a financial institution as follows:

“Financial Institution” means a holding company, any regulated financial corporation, a subsidiary of a holding company or regulated financial corporation, or any other corporation organized under the laws of the United States or any other taxing jurisdiction that is carrying on the business of a financial institution. However, “financial institution” does not include insurance companies subject to tax under §§56-4-201 - 56-4-214.

T.C.A. § 67-4-804(a)(2)(A) defines the meaning of the phrase “business of a financial institution”. Under Subparagraph (iii) of subitem (A), the “business of a financial institution” can be defined as:

Otherwise making, acquiring, selling or servicing loans or extensions of credit including, but not limited to, the following:

- (a) Secured or unsecured consumer loans;
- (b) Installment loans;

- (c) Mortgage or deeds of trust or other secured loans on real or tangible personal property;
- (d) Credit card loans;
- (e) Secured or unsecured commercial loans of any type;
- (f) Letters of credit and acceptance of drafts;
- (g) Loans arising in factoring; and
- (h) Any other transaction of a comparable economic effect;

However, T.C.A. § 67-4-804(2)(B) provides that, if the business of a financial institution conducted by a corporation generates less than 50% of the corporation's gross income, it will not be considered a financial institution.

Company X will periodically purchase accounts receivable from The Taxpayer without recourse and will service, collect and maintain such accounts. Company X may also be engaged to provide credit approval services for The Taxpayer and to service accounts receivable generated and held by The Taxpayer prior to their sale to Company X.

The activities in which Company X will engage are among those enumerated in T.C.A. § 67-4-804(a)(2)(A)(iii) and they generate more than 50% of the corporation's income. Therefore, for Tennessee franchise, excise tax purposes, Company X is a financial institution under T.C.A. §67-4-804(a)(7).

2. *COMPANY X WILL NOT BE REQUIRED
TO FILE A COMBINED FRANCHISE, EXCISE TAX RETURN*

T.C.A. §§ 67-4-805(a)(3) and 67-4-919(b) require unitary businesses to file Tennessee corporate franchise, excise tax returns on a combined basis in the manner specified by the law. T.C.A. § 67-4-804(a)(16) defines a unitary business as follows:

"Unitary business" means business activities or operations of financial institutions that are of mutual benefit, dependent upon, or contributory to one another, individually or as a group, in transacting the business of a financial institution.

"Unitary business" may be applied within a single legal entity or between multiple entities. "Unitary group" includes those entities that are engaged in a unitary business wholly within or within and without this state;

(A) Unity is presumed whenever there is unity of ownership, operation and use evidenced by centralized management or executive force, centralized purchasing, advertising, accounting or other controlled interaction among entities that are engaged in the business of a financial institution. The absence of these centralized activities does not, however, necessarily evidence a nonunitary business;

(B) Unity of ownership does not exist unless the corporation is a member of two (2) or more business entities and more than fifty percent (50%) of the voting stock of each member is directly or indirectly owned by:

- (i) A common owner or common owners, either corporate or noncorporate; or
- (ii) One (1) or more of the members of the group;

Under Tennessee law, a corporation that is a financial institution can not be unitary with a corporation that is not a financial institution because the term “unitary business” is defined by T.C.A. § 67-4-804(a)(16) as the “. . . business activities or operations of financial institutions . . .”. Company X, a financial institution, can not be unitary with The Taxpayer, a manufacturer. Since Tennessee law permits only unitary businesses to file combined franchise, excise tax returns, Company X will not be permitted or required to file a combined franchise, excise tax return with its parent, The Taxpayer. The Tennessee corporate franchise, excise tax return of Company X must be filed on a separate entity basis to include only its own operations.

3. *APPORTIONMENT PROVISIONS APPLICABLE TO COMPANY X*

Initially, Company X will probably make no loans, but will have interest income and other receipts from assets in the form of accounts receivable it has purchased from The Taxpayer. T.C.A. § 67-4-815(a) and (d)(2)(A) make the following provisions concerning excise tax apportionment by a financial institution not filing a combined franchise, excise tax return and having interest income and other receipts from assets in the nature of loans or installment sales contracts that deal with tangible personal property.

(a) A financial institution which is not filing a combined return and which has earnings from business activity both within and without this state shall apportion its business earnings by multiplying such earnings by the quotient of the institution's total receipts attributable to the transaction of business in Tennessee, as determined under subsection (d), divided by the institution's total receipts attributable to transacting business in all taxing jurisdictions, as determined under subsection (d).

(d)(2)(A) Interest income and other receipts from assets in the nature of loans or installment sales contracts that are primarily secured by or deal with real or tangible personal property shall be attributed to Tennessee if the security or sale property is located in Tennessee. If any part of the sale property or property standing as security for the payment of the debt is located part within and part without the state, only such proportion of the interest income or other receipts shall be attributed to Tennessee as the value of the property within the state bears to the whole property.

T.C.A. § 67-4-919(a) and (d)(2)(A) make similar provisions for franchise tax apportionment by a financial institution not filing a combined franchise, excise tax return and having interest income and other receipts from assets in the nature of loans or installment sales contracts that deal with tangible personal property.

Company X will use a single factor gross receipts apportionment formula to apportion net earnings for excise tax purposes and outstanding stock, surplus and undivided profits for franchise tax purposes. All interest income and other receipts from the accounts receivable purchased by Company X from The Taxpayer will be included in the

denominator of Company X's apportionment formula. The accounts receivable purchased by Company X are unsecured. Accordingly, interest income and other receipts from the accounts receivable purchased by Company X from The Taxpayer will be included in the numerator of Company X's apportionment formula to the extent that sale property related to the accounts receivable was delivered or shipped by The Taxpayer to a purchaser or recipient located in Tennessee. For purposes of Company X's apportionment formula, receipts other than the interest and other receipts described, if any, will be attributed to Tennessee in accordance with the provisions of T.C.A. §§ 67-4-815 and 67-4-919.

Arnold B. Clapp, Senior Tax Counsel

APPROVED: Ruth E. Johnson, Commissioner

DATE: 12/18/96